

DEPARTMENT OF STATE REVENUE

04970497.LOF

LETTER OF FINDINGS NUMBER: 97-0497 ST

Sales & Use Tax

For Tax Period: 1993 Through 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales & Use Tax - Construction Contracts

Authority: 45 IAC 2.2-4-22(b); 45 IAC 2.2-4-23(3)

Taxpayer protests the imposition of sales/use tax on materials used in construction contracts.

II. Sales & Use Tax - Tangible Personal Property

Authority: IC 6-2.5-1-1

Taxpayer protests the imposition of sales/use tax on the purchase of tangible personal property.

III. Sales & Use Tax - In-Production Testing

Authority: 45 IAC 2.2-5-8

Taxpayer protests the imposition of sales/use tax on materials used during in-production testing.

IV. Sales & Use Tax - Sample Period

Taxpayer protests the use of tax year 1995 as the sample period.

V. Sales & Use Tax - Interest and Penalty

Authority: IC 6-8.1-10-1; IC 6-8.1-10-2.1

Taxpayer protests the imposition of interest and penalty.

STATEMENT OF FACTS

Taxpayer was a manufacturer of refrigerated dough products. A sales and use tax audit was performed for the period January 1, 1993 through December 31, 1995. The audit resulted in several adjustments. Taxpayer protests a number of these adjustments, and the accompanying penalty and interest. Additional facts will be provided below, as necessary.

I. Sales & Use Tax - Construction Contracts

DISCUSSION

The auditor made adjustments on the sales tax liability for materials used in construction contracts. Materials used for production equipment and production lines were excluded from the adjustments. The auditor found the cost of materials in the taxpayer's construction contracts included a markup, overhead costs and additional subcontracts. An adjustment was made by the Department to assess tax on the cost of material only.

Department Regulations 45 IAC 2.2-4-22(b) and 45 IAC 2.2-4-23(3) provide for a contractor's liability for sales tax on materials that could not be purchased tax exempt by the ultimate recipient. 45 IAC 2.2-4-22(b) states:

A contractor, who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material 'tax free', is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property unless the ultimate recipient could have purchased it exempt.

In the alternative, 45 IAC 2.2-4-23(3) reads:

A contractor has no further liability for either the state gross retail tax or use tax with respect to construction material acquired by the contractor in a taxable transaction, provided the contractor disposes of such property in the following manner:

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

Taxpayer claims the sales tax was paid by the contractor or subcontractor on all non-production materials and was included in the contract price paid by taxpayer. Taxpayer concedes it presented a tax-exempt certificate for one \$5,000 contract but denies that it used a blanket certificate to avoid sales tax. Taxpayer submits an affidavit from the Controller of Company B (a contractor) which states in part, "[Company B] paid all applicable sales/use taxes owed on materials incorporated into and/or used in performance of all contracts for [taxpayer]. . . for the period January, 1993 through December, 1995."

FINDING

Taxpayer's protest is sustained. Taxpayer has proven to the Department's satisfaction that all sales and use taxes were properly paid on materials, not used in production, by the contractor. Taxpayer's construction contracts included the cost of sales tax.

II. Sales & Use Tax - Tangible Personal Property

DISCUSSION

Taxpayer protests the adjustment made to purchases from Vendor O for tangible personal property.

The auditor states there are two issues. First, the contract for the sale of personal property that remains personal property after installation is considered to be a unitary transaction and the total amount is taxable. Second, repair materials were purchased and no sales tax was charged on the invoices.

Purchases made from Vendor O were not for production materials, and, therefore, are not exempt from sales tax. Taxpayer purchased dock levelers, repair materials for dock doors, storage building doors, etc. These items are used in the pre- and post-production processes. The auditor found the dock levelers were billed on a lump-sum basis but that the purchase and installation of the dock levelers can not be properly billed on a lump-sum basis. The auditor considered this a unitary transaction and subject to sales tax pursuant to IC 6-2.5-1-1.

The auditor also found that although the repair materials for the dock doors, storage building doors, etc. were separately stated there was no sales tax charged on the invoice.

The taxpayer submits a letter from Vendor O stating that all invoices stated they were "tax exempt" as the tax was figured into the contract total. The notation simply told the vendor's computer not to add tax again.

As in Issue I, the taxpayer has provided evidence that the vendor was responsible for the payment of sales tax. The items could not have been purchased tax exempt by the taxpayer and sales tax was figured into the contract price paid to the vendor.

FINDING

Taxpayer's protest is sustained. Taxpayer has proven to the Department's satisfaction that sales tax was due from Vendor O on purchases for non-production materials. Taxpayer has sufficiently proven sales tax was figured into the contract prices paid to Vendor O.

III. Sales & Use Tax - In-Production Testing

DISCUSSION

Taxpayer protests the imposition of tax on quality assurance items used to test the products produced by the taxpayer. These quality assurance items include petrifilm which was used to test the color, texture, and chemical make-up of the products. Once the product was removed from the production process for testing it was not reintroduced into the product line. Often the taxpayer would cook the product and allow its employees to eat it. The auditor found this to be destructive testing and no tax exemption available to these quality assurance items.

Taxpayer protests and claims this testing was a necessary part of the production process. Taxpayer states every batch of the product was tested and if it was not up to specifications that batch was disposed of and adjustments were made to insure the next batch was satisfactory. Taxpayer argues this was a necessary and essential element of the production process. Taxpayer cites 45 IAC 2.2-5-8(i) which states:

Testing and inspection. Machinery, tools, and equipment used to test and inspect the product as part of the production process are exempt.

The example following the regulation reasons that when selected parts are removed from production, according to a schedule dictated by statistical sampling methods, and tested separate from the production line, an interrelationship between the testing equipment and the machinery on the production line is formed. The testing is then an integral part of the integrated production process and is exempt. 45 IAC 2.2-5-8(i) Example.

FINDING

Taxpayer's protest is sustained. Taxpayer has shown the equipment and materials used in in-production testing are an integrated part of the production process and are exempt from tax.

IV. Sales & Use Tax - Sample Period

DISCUSSION

Because of the volume of invoices involved, the taxpayer and auditor agreed to a sampling period which would be used to compute a projection of taxable purchases. Taxpayer signed an "Agreement for Projecting Audit Results" which stipulated that 1995 would be used to project for the entire audit period.

Taxpayer claims 1995 was not a representative tax year. Taxpayer states 1995 was chosen as those records were readily accessible but that 1995 had the least amount of tax accrued and paid.

FINDING

Taxpayer's protest is denied. The agreement to use 1995 as the sample year is binding upon the taxpayer.

V. Sales & Use Tax - Interest and Penalty

DISCUSSION

Taxpayer requests the abatement of interest and penalty on the proposed assessment. Taxpayer claims that any tax due was not the result of evasive action but generally resulted from clerical accounting errors and a misunderstanding of Indiana laws and regulations.

Pursuant to IC 6-8.1-10-1(e), the Department may not waive the interest imposed under IC 6-8.1-10-1. Pursuant to IC 6-8.1-10-2.1(e):

A person who wishes to avoid the penalty imposed under this section must make an affirmative showing of all facts alleged as a reasonable cause for the person's failure to... pay the deficiency...

FINDING

Taxpayer's protest is sustained in part and denied in part. For those issues which were sustained above, the interest and penalty assessed is abated. For those issues which were denied above, the taxpayer's protest of interest and penalty is denied. Taxpayer has failed to show a reasonable cause for the failure to pay tax on those issues denied above.